FORTRESS PAPER LTD.

Q3 2011

FOR THE THREE AND NINE MONTHS ENDED

SEPTEMBER 30, 2011

FORTRESS PAPER LTD.
MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD&A") of the financial condition and results of operations of Fortress Paper Ltd. ("we", "our", "Fortress" or the "Company") has been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). In 2010, the CICA Handbook was revised to incorporate International Financial Reporting Standards ("IFRS"), and require publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, the company has commenced reporting on this basis and this MD&A should be read in conjunction with the unaudited consolidated financial statements and the notes thereto for the nine month period ended September 30, 2011 (available on SEDAR at www.sedar.com). The MD&A provides a review of the significant developments that have impacted the Company's performance during the quarter ended September 30, 2011 relative to the previous quarter and prior year comparative quarter.

This MD&A contains certain forward-looking statements that reflect the current views and/or expectations of the Company with respect to its performance, business and future events. The reader is cautioned that forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements including, without limitation, those relating to damage to our reputation, competition, maintaining our market position, marketability and price of our products, technology and protection of our intellectual property, dependence on our major customers, fluctuations in the price and supply of raw materials, fluctuations in foreign exchange and other risk factors detailed in our filings with Canadian securities regulatory authorities. These risks, as well as others, could cause actual results and events to vary significantly. The Company does not undertake any obligation to release publicly any revisions for updating any voluntary forward-looking statements, except as required by law.

Throughout this discussion, reference is also made to EBITDA (defined as net income before interest, income taxes, depreciation, amortization, non-operating income and expenses and stock based compensation), which the Company considers to be an indicative measure of operating performance and a good metric to evaluate profitability. Reference is also made to adjusted net income (loss) (calculated as net income (loss) less specific items affecting comparability with prior periods) and adjusted net income (loss) per share (calculated as adjusted net income (loss) divided by the weighted average number of shares outstanding in the period). EBITDA, adjusted net income (loss) and adjusted net income (loss) per share are not generally accepted earnings measures and should not be considered as an alternative to net income or cash flows as determined in accordance with Canadian GAAP. As there is no standardized method of calculating these measures, the Company's EBITDA, adjusted net income (loss) and adjusted net income (loss) per share may not be directly comparable with similarly titled measures used by other companies. Reconciliations of EBITDA and adjusted net income (loss) to net income (loss) reported in accordance with GAAP are included in this MD&A.

The information in this report is as at November 4, 2011.

Description of Business

The Company was incorporated on May 30, 2006 under the laws of the Province of British Columbia. Fortress Paper Ltd. is an international producer of security and other specialty papers and products. The Company owns and operates three mills, the Landqart mill located in Switzerland, the Dresden mill located in Germany and the Fortress Specialty Cellulose mill located in Quebec, Canada. Fortress' security papers include banknote, passport, visa papers and security threads. The security papers produced at the Landqart mill incorporate internationally recognized overt and covert security features which are embedded into the paper and supplemented with customer-specific features. The Landqart mill has leveraged its extensive security papers competence to develop additional commercial applications using its in-house know-how and technology of security features to create innovative paper-based security products ("Security and Specialty Paper Segment"). The Landqart mill also produced specialty papers including non-woven wallpaper base, graphic and technical papers. The final sale of specialty papers was made in the first quarter of 2011. The Dresden mill produces coated and uncoated wallpaper base for wallpaper manufacturers ("Wallpaper Base Papers Segment"). Fortress Paper's pulp business ("Pulp Segment") includes specialty pulp produced at the Fortress Specialty Cellulose mill currently in process of converting this capacity into dissolving pulp production along with the construction of a biomass based cogeneration plant. The segmentation of the Company's manufacturing operations is based on a number of factors, including production, production processes, and economic characteristics.

Highlights

Fortress reported a 2011 third quarter EBITDA loss of $0.8 million. For the second quarter of 2011 EBITDA was $4.6 million and for the three months ended September 30, 2010 EBITDA was $8.8 million.

Fortress reported an adjusted net loss of $7.8 million for the third quarter of 2011 on sales of $84.0 million or diluted adjusted loss per share of $0.54. In the second quarter of 2011 the Company reported an adjusted net loss of $1.0 million on sales of $89.9 million or a diluted adjusted loss per share of $0.07. For the third quarter of 2010 the Company reported adjusted net income of $3.7 million or diluted adjusted earnings per share of $0.28 on sales of $87.0 million.

Similar to the prior quarter, the Pulp Segment produced specialty pulp throughout the quarter which resulted in comparative cost per tonne, but a lower price relative to the prior quarter due to a deterioration in the premium realized relative to the second quarter. As previously disclosed, the necessary shut-down of the mill for conversion to dissolving pulp was re-scheduled and we experienced a temporary work delay as a result of an unexpected walkout by unionized construction employees. As a result, we now expect that dissolving pulp production will commence no later than mid-November 2011. Dissolving pulp sales are anticipated to provide significantly higher margins than previous NBHK and specialty pulp sales.

The Wallpaper Segment produced another strong quarter which was comparable to the previous quarter result. Sales were strong throughout the quarter and margins remained stable.

The challenges experienced by the Security and Specialty Paper Segment continued in the third quarter. An increase in security paper theoretical capacity at the Landqart mill from 2,500 tonnes to 10,000 tonnes became available at a time where there was a general softening in banknote orders industry wide, due in part to a delay in the re-design of the Euro and Swiss Franc banknotes, resulting in primarily smaller legacy orders being produced at the Landqart Mill. While high raw material prices, a strong Swiss currency together with low utilization have contributed to another difficult quarter, the Landqart Mill is now in the process of overcoming the low utilization with recent new contract orders representing a significant portion of Landqart’s 2012 banknote capacity.

Management’s Outlook

This was our final quarter in the specialty pulp market as the focus now turns towards the shutdown and conversion to dissolving pulp. The fourth quarter of 2011 will be one of significant transition as conversion, testing and ramp up towards full production of dissolving pulp will re-define our Pulp Segment.

EBITDA from the non-woven wallpaper base segment was down only 4% from the prior quarter as we completed an additional upgrade of our facility during the annual August maintenance shutdown. The upgrade was successful and has resulted in over 10% additional capacity compared to the total capacity in 2010. Margins remain strong and the order log is healthy.

The security and specialty paper segment experienced another challenging quarter. The converted PM1 high security paper-machine is performing to specifications; however, similar to the first and second quarter of 2011, the Landqart mill’s third quarter 2011 results were impacted by high raw material costs and industry over-capacity due in part to the postponement of several major currencies. In addition, the strong Swiss exchange rate continues to have a negative impact on the operational cost structure of the mill. With recent banknote orders, utilization will improve and capacity of both paper machines are expected to be required to meet demands through 2012.

Third Quarter 2011 Earnings Review

Three Months Ended September 30, 2011

Overview

Fortress reported a 2011 third quarter EBITDA loss of $0.8 million. For the three months ended September 30, 2010, EBITDA was $8.8 million and for the second quarter of 2011 EBITDA was $4.6 million.

Analysis of Specific Items Affecting Comparability of Net Income

(thousands of dollars, except per share figures, unaudited)	**Q3 2011**	**Q2 2011**	**Q3 2010**
Net income (loss) as reported	(7,237)	2,907	5,232
Foreign exchange (gain) loss	(525)	(3,889)	(1,483)
Adjusted net (loss) income	(7,762)	(982)	3,749
Diluted net income (loss) per share	(0.51)	0.19	0.39
Diluted adjusted (loss) net income per share	(0.54)	(0.07)	0.28

Cost of products sold were $75.5 million or 90.0% of sales for the three months ended September 30, 2011 compared to $76.1 million or 84.6% in the second quarter of 2011. In the third quarter of 2010, cost of products sold were $69.9 million or 80.4% of sales. Cost of products sold increased as a percent of sales, primarily due to the decrease in the realized price for the specialty pulp compared to the prior quarter in the Pulp Segment. In addition the Security Paper Segment continued to experience a challenging environment including currency strength, high raw materials and low utilization.

Selling, general and administrative (SG&A) expenses were $9.3 million for the third quarter of 2011 (third quarter 2010, $8.2 million and second quarter 2011, $9.2 million). Relative to the prior year comparative period SG&A is higher due to increased corporate activity including the integration of Fortress Optical Features.

Stock-based compensation expense was $0.5 million during the period ($0.6 million in both the third quarter of 2010 and the second quarter of 2011).

Selected Financial Information and Statistics

(thousands of dollars, except per unit amounts and shipments, unaudited)	**Q3 2011**	**Q2 2011**	**Q3 2010**
Sales	83,995	89,906	86,972
EBITDA[1]	(758)	4,601	8,800
Operating income (loss)	(4,876)	619	5,932
Net income (loss)	(7,237)	2,907	5,232
Adjusted net (loss) income	(7,762)	(982)	3,749
Paper Shipments (tonnes)	13,383	14,670	16,452
Pulp Shipments (tonnes)	55,918	54,384	60,469

[1]See net income to EBITDA reconciliation.

Net income to EBITDA reconciliation:

(thousands of dollars, unaudited)	Q3 2011	Q2 2011	Q3 2010
Net income (loss)	(7,237)	2,907	5,232
Income tax expense	2,051	740	2,063
Foreign exchange (gain) loss	(525)	(3,889)	(1,483)
Net interest expense	835	861	120
Amortization	3,668	3,394	2,229
Stock based compensation	450	588	639
EBITDA	(758)	4,601	8,800

Operating Results by Business Segment

Pulp

(thousands of dollars, except for shipments, unaudited)	Q3 2011	Q2 2011	Q3 2010
Sales	36,887	39,961	37,219
Operating income (loss)	(859)	3,316	4,442
Shipments (tonnes)	55,918	54,384	60,469

Although the Pulp Segment produced specialty pulp, similar to the second quarter, the higher pricing realized in the previous quarter failed to materialize. In the prior year comparative period northern bleached hardwood kraft ("NBHK") pulp was produced in a relatively stronger pricing environment for the commodity. The transition of the Fortress Specialty Cellulose mill to dissolving pulp is currently scheduled for mid-November 2011.

Wallpaper Base Papers Segment

(thousands of dollars, except for shipments, unaudited)	Q3 2011	Q2 2011	Q3 2010
Sales	35,778	36,566	30,221
Operating income	6,371	6,804	4,470
Shipments (tonnes)	12,661	13,357	10,159

Tonnes shipped in the third quarter of 2011 were comparable, but slightly lower than the previous quarter and significantly higher relative to the prior year comparative period due to the capital programs to increase capacity. Margins improved relative to the prior year comparative quarter and remained stable compared to the second quarter of 2011. This is a result of lower costs associated with decreased NBHK pulp prices and higher sales prices realized in the current and previous quarters relative to the third quarter of 2010. The Wallpaper Base Segment completed an additional upgrade of our facility during the annual August maintenance shutdown. The upgrade was successful and has added approximately 10% additional capacity. The order book at the Dresden mill remains strong.

Security and Specialty Papers Segment

(thousands of dollars, except for shipments, unaudited)	Q3 2011	Q2 2011	Q3 2010
Sales	11,330	13,379	19,532
Operating loss	(8,258)	(6,779)	(472)
Shipments (tonnes)	722	1,313	4,145

Effective October 31, 2010 the last of the specialty papers were produced at the Landqart mill. Shipments in the second quarter of 2011 consisted only of security papers. In the previous quarter shipments consisted of security papers and 514 tonnes of non-woven simplex wallpaper. In the prior year comparative period specialty paper sales were largely influenced by non-woven simplex wallpaper base representing 1,834 tonnes of the shipments. Specialty papers are no longer produced at Landqart as the mill has fully converted to a security paper producer.

Results reflect continued headwinds of a strong Swiss franc, high raw material costs, and over capacity resulting in part from delays in several major new currency launches. With significant new banknote paper orders that have been recently placed at our mill, the Security and Specialty Papers Segment will be in a position to improve utilization of the capacity for both its banknote paper machines.

Our wholly owned subsidiary, Fortress Optical Features Ltd., began operations in 2011 generating sales of $0.5 million and $0.3 million in the third quarter and second quarter of 2011, respectively. Fortress Optical Features produces security material for the security threads used in banknotes.

Nine Months Ended September 30, 2011

Analysis of Specific Items Affecting Comparability of Net Income

(thousands of dollars, except per share figures, unaudited)	September 30, 2011	September 30, 2010
Net (loss) income as reported	(10,059)	46,647
Foreign exchange (gain) loss	(4,293)	1,724
Fair value gain on acquisition	-	(41,804)
Start-up costs associated with Fortress Specialty Cellulose mill	-	3,368
Adjusted net income	(14,352)	9,935
Net (loss) income per share (EPS), as reported	(0.72)	4.31
Net (loss) income per share (EPS) diluted, as reported	(0.72)	3.92
Adjusted (loss) net income per share	(1.03)	0.84
Adjusted (loss) net income per share diluted	(1.03)	0.83

Selected Financial Information and Statistics for the Nine Months Ended:

(thousands of dollars, except for shipments, unaudited)	**September 30, 2011**	**September 30, 2010**
Sales	259,389	197,820
EBITDA[1]	4,791	22,234
Operating (loss) income	(7,359)	11,734
Net (loss) income	(10,059)	46,647
Adjusted net (loss) income	(14,352)	9,935
Paper Shipments (tonnes)	43,421	49,162
Pulp Shipments (tonnes)	166,663	79,317

[1]See net income to EBITDA reconciliation.

Net income to EBITDA reconciliation:

(thousands of dollars, unaudited)	**September 30, 2011**	**September 30, 2010**
Net income	(10,059)	$46,647
Income tax	4,327	4,598
Foreign exchange (gain) loss	(4,293)	1,724
Fair value gain on purchase	-	(41,804)
Start-up costs	-	3,368
Interest expense	2,666	569
Amortization	10,570	5,522
Stock based compensation	1,580	1,610
EBITDA	4,791	22,234

Overview

EBITDA for the Company was $4.8 million for the nine months ended September 30, 2011 compared to $22.2 million in the nine months ended September 30, 2010. The best nine month results for the Dresden mill on record were offset by the challenges experienced by the Landqart mill. In the Pulp Segment, the Fortress Specialty Cellulose mill continued efforts to maximize returns producing a specialty pulp product prior to the conversion to the higher margin dissolving pulp production scheduled for mid-November 2011.

Total paper product shipments were lower compared to the prior comparative period due to the conversion of the Landqart mill to security papers where in the prior year much of the tonnage was the result of specialty paper production. Partially offsetting the decrease in tonnes shipped from Landqart was increased sales and capacity at the Dresden mill.

Total NBHK pulp and specialty pulp shipments reflect a full nine months of sales from Fortress Specialty Cellulose mill in 2011, compared to approximately four months of sales in 2010 as the mill ramped up production in late May after having been idle for some time. The mill in Thurso was purchased April 30, 2010.

In early January 2011, Fortress completed the acquisition of the assets of the Bank of Canada's Optical Security Material (OSM) division (the "OSM Assets"), which produces the optically variable material for the security threads contained in various banknotes, including application in the Canadian banknotes. The Company paid a purchase price of $0.75 million for the OSM assets and granted the Bank of Canada a royalty-free license to use the intellectual property sold to the Company for Canadian banknote applications. The assets have been relocated to a high security production and research facility which the Company built adjacent to its Fortress Specialty Cellulose mill in Quebec.

In February of 2011, Fortress completed a public offering (the "2011 Offering") of 967,000 common shares of the Company and the underwriters exercised their over-allotment option and purchased an additional 145,050 common shares at a price of $51.75 per share, resulting in aggregate gross proceeds under the offering of $57.5 million. Proceeds of the 2011 Offering were used to finance certain capital expenditures relating to our Fortress Specialty Cellulose mill and the construction of the high security facility adjacent to the Fortress Specialty Cellulose mill, and for working capital and general corporate purposes.

Also in the nine month period ended September 30, 2011, Fortress' wholly-owned subsidiary Dresden Papier GmbH ("Dresden") increased the current credit facility amounting to EUR18.5 million to EUR 22.15 million for the rebuild of Landqart's PM1 into a banknote and high security papers paper-machine.

The remaining $7 million principal amount of the Company's $15 million unsecured convertible debenture that was issued on April 30, 2010 was converted into 350,000 common shares.

On June 17, 2009 the Canadian Federal Government announced the Pulp and Paper Green Transformation Program (the "Program"). The Program is designed as a reimbursement of funds to be spent on qualifying energy and environmental capital projects. Credits may be used until the program end date of March 31, 2012. The Company has been allocated $9.9 million from the Program announced by the Canadian government on June 28, 2011. The Company has received Program approval to apply the funding to the installation of lime kiln and recovery boiler upgrades at the Fortress Specialty Cellulose mill. These projects are expected to provide economic and environmental benefits to the Company's operations. As at September 30, 2011 the Company had received $2.0 million under the program and recorded $3.1 million as other receivables. The remaining $4.8 million is expected to be received before year end.

Operating Results by Business Segment

Pulp Segment

(thousands of dollars, except for shipments, unaudited)	**September 30, 2011**	**September 30, 2010**
Sales	112,434	50,762
Operating income (loss)	1,515	3,318
Operating income adjusted for start-up costs	-	6,686
Shipments (tonnes)	166,215	79,317

Results in the prior year nine month period reflect production from the Fortress Specialty Cellulose mill beginning in late May. Current period results reflect efforts made to produce specialized pulp to maximize returns while preparing employees for conversion to dissolving pulp.

Wallpaper Base Papers Segment

(thousands of dollars, except for shipments, unaudited)	**September 30, 2011**	**September 30, 2010**
Sales	109,345	90,345
Operating income	20,181	14,049
Shipments (tonnes)	40,513	35,912

Tonnes shipped in the first nine months of 2011 were 13% higher than the comparable prior year period due to the capital programs to increase capacity. Pricing and margins also improved relative to the prior year comparative quarter as overall raw material prices have receded.

Security and Specialty Papers Segment

(thousands of dollars, except for shipments, unaudited)	**September 30, 2011**	**September 30, 2010**
Sales	37,610	56,713
Operating (loss) income	(21,680)	(226)
Shipments (tonnes)	3,522	13,250

Product mix, high raw material prices, pricing pressure, a strong Swiss currency and low utilization have contributed to a difficult first nine months. With significant new banknote paper orders the Security and Specialty Papers Segment will be in a position to improve utilization of the capacity for both its banknote paper machines in the fourth quarter of 2011.

The final sale of specialty paper in the first nine months of 2011 was 514 tonnes of simplex non-woven wallpaper base that was sold from inventory. The Landqart Mill has now been fully converted to a security paper producer. In the prior year comparative period, sales reflect security and specialty papers of which 4,888 tonnes were of simplex non-woven wallpaper base.

Fortress Optical Features began operations in 2011 and generated sales of $1.7 million in the first nine months of 2011 and contributed slightly to the operating loss.

Liquidity and Capital Resources

The Company's objectives when managing capital are to safeguard its assets and maintain a globally competitive cost structure while looking for growth opportunities to provide returns to its shareholders. In addition, the Company works with relevant stakeholders to ensure the safety of its operations and employees, and remain in compliance with all environmental regulations and enhance the communities in which it operates.

The Company constantly monitors and assesses its financial performance in order to ensure that its net debt levels are prudent, taking into account the anticipated direction of the Company and business cycle. The company continuously monitors the public and private debt markets and the public equity markets in order to assure that its capital structure is appropriately balanced. The Company's results can be materially influenced by changes in the relative value of the Swiss Franc, Euro and US dollar to the Canadian dollar.

As at September 30, 2011 and the date of this report, the Company has made aggregate expenditures of approximately $85.3 million and $100.6 million, respectively, on the conversion of Fortress Specialty Cellulose mill from a NBHK producer to a high quality specialty cellulose mill and the construction of a new co-generation facility thereat. As previously disclosed, the total combined project costs are estimated to be approximately $178 million. Subsequent to the quarter end, the Fortress Specialty Cellulose mill experienced a temporary work delay when unionized employees of the contractors engaged on the dissolving pulp conversion and cogeneration projects walked out. The Company has not yet quantified the impact of this delay. During the later stages of the conversion project, management identified additional infrastructure upgrades that will be required in the normal course. Project financing of $102.4 million from Investissement Quebec, current cash, federal credits, cash from operations, and net proceeds from the 2011 Offering are expected to provide sufficient funds for completion of this project.

The market challenges experienced by the Security and Specialty Papers Segment continued in the third quarter. Although the Landqart Mill has experienced high raw material costs, a strong Swiss currency and low utilization in the third quarter and nine month period ended September 30, 2011, the Landqart Mill currently has new banknote paper orders filling a significant portion of its 2012 banknote production capacity.

The Wallpaper Segment produced another strong quarter complimenting the year-to-date results.

Although there can be no assurances, Fortress believes that cash generated from operations, together with amounts available under its credit facilities and net proceeds from equity financing will be sufficient to meet its debt service requirements, capital expenditure needs and short term working capital needs. Fortress' future operating performance and its ability to service its debt and pay other indebtedness of Fortress will be subject to future economic conditions, the financial success of Fortress' business, the ramp-up of its dissolving pulp production and other factors, some of which are not within Fortress' control, including but not limited to changes in market prices for its products and raw material costs. Fortress may determine, in its sole discretion, that such conditions and factors may warrant that it seek additional sources of capital on terms satisfactory to Fortress, in order to fund future working capital needs, enhance liquidity or for other general corporate purposes.

At September 30, 2011, the Company had cash of $14.6 million and debt of $95.9 million. Included in this indebtedness is $51.8 million drawn on the $102.4 million credit facility with Investissement Quebec previously referenced. Of the amount drawn, $20.1 million is included in other accounts receivable and has been received subsequent to September 30, 2011.

Operating Activities

Selected Cash Flow Items

	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Cash provided before working capital changes	137	15,825
Non-cash working capital change	(10,174)	(12,011)
Cash provided from (used by) operating activities	(10,037)	3,814
Net proceeds on common share issuance including option exercises	55,421	42,347
Net proceeds from debt	26,141	27,452
Cash provided from financing activities	81,562	69,799
Cash provided from (used by) investing activities	(99,107)	(39,419)
Change in cash position	(27,582)	34,194
Foreign exchange (loss) gain on cash and cash equivalents	(407)	(1,912)

Fortress operates in a cyclical industry and its operating cash flows vary accordingly. Fortress' principal operating cash expenditures are for compensation and raw materials. Operating activities used cash of $10.0 million in the nine months ended September 30, 2011 compared to $3.8 million in the first nine months of 2010.

Working capital is subject to cyclical operating needs, the timing of collection of receivables and the payment of payables and expenses.

Financing Activities

In the first nine months of 2011, financing activities generated $81.6 million. In February 2011, Fortress completed the 2011 Offering resulting in aggregate net proceeds of $54.8 million. Proceeds received from option exercises were $0.6 million. Also in the nine months of 2011, proceeds from debt were $35.1 million, primarily for the conversion project ongoing at the Fortress Specialty Cellulose mill. Payments on debt and debt interest used cash of $7.3 million and $1.7 million, respectively.

In the first nine months of 2010, financing activities generated $69.8 million related to loan proceeds of $26.0 million, debt repayment of $1.6 million and finance expenses paid of $0.4 million.

Investing Activities

Investing activities in the first nine months of 2011 and 2010 used cash of $99.1 million and $39.4 million, respectively. Investment activities relate primarily to the purchase of equipment and other capital expenditures at the mills.

Outstanding Shares

The number of common shares outstanding at September 30, 2011 and the date of this report was 14,291,886 and 14,300,086, respectively. The number of options outstanding at September 30, 2011 and the date of this report was 574,925 and 566,725 respectively. At September 30, 2011 and the date of this report there were 266,172 restricted share units outstanding. At September 30, 2011 and the date of this report there were 142,264 and 142,873 deferred share units outstanding, respectively.

Critical Accounting Estimates

The preparation of financial statements and related disclosures in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Significant estimates are used for, but not limited to, the accounting for doubtful accounts, depreciation and amortization, asset impairments, valuation of equity investment, derivative financial instruments, allocation of purchase price of acquisitions, stock based compensation, pensions and post-retirement obligations, income taxes and contingencies. Actual results could differ from these estimates.

Changes in Accounting Policies

Transition to and Initial Adoption of International Financial Reporting Standards

The company prepares its financial statements in accordance with Canadian generally accepted accounting principles as set out in the Handbook of the Canadian Institute of Chartered Accountants ("CICA Handbook"). In 2010, the CICA Handbook was revised to incorporate International Financial Reporting Standards ("IFRS"), and require publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, the company has commenced reporting on this basis in the condensed interim consolidated financial statements as at March 31, 2011. For additional information on the conversion to IFRS, see the 2010 annual MD&A, the unaudited interim condensed consolidated financial statements for the first quarter and the unaudited interim condensed consolidated financial statements for the third quarter of 2011, accompanying this MD&A.

Impact of Adopting IFRS on the Company's Business

The adoption of IFRS has resulted in some changes to the Company's accounting systems and business processes. However, the impact has been minimal. The Company has not identified any contractual arrangements that are significantly impacted by the adoption of IFRS. The Company's staff involved in the preparation of financial statements has been appropriately trained on the relevant aspects of IFRS and the changes to accounting policies. The Company's Audit Committee has been regularly updated throughout the IFRS transition process, and is aware of the key aspects of IFRS as they impact the Fortress.

New Accounting Pronouncements

In the first nine months of 2011, the International Accounting Standards Board ("IASB") issued a number of new and revised accounting standards which are effective for annual periods beginning on or after January 1, 2013, with early adoption permitted. These standards include the following:

- IFRS 9, Financial Statements;
- IFRS 10, Consolidated Financial Statements,
- IFRS 11, Joint Arrangements,
- IFRS 12, Disclosure of Interests in Other Entities; and,
- IFRS 13, Fair Value Measurement,
- IAS 19, Employee Future Benefits

These new and revised accounting standards have not yet been adopted by Fortress, and the Company has not yet completed the process of assessing the impact that they will have on its financial statements or whether to early adopt any of the new requirements.

Disclosure Controls and Internal Controls over Financial Reporting

During the quarter ending September 30, 2011, there were no changes in the Company's internal controls over financial reporting that materially affected, or would be reasonably likely to materially affect, such controls.

Risks and Uncertainties

A comprehensive discussion of Risk Factors is included in the Company's 2010 annual information form available on SEDAR at www.sedar.com.

Selected Quarterly Information

(thousands of dollars, except per unit amounts, earnings per share ("EPS"), exchange rates and shares outstanding, unaudited)	International Financial Reporting Standards (IFRS) Q3 2011	Q2 2011	Q1 2011	Q4 2010
Sales	83,995	89,906	85,488	83,467
Operating (loss) income	(4,876)	619	(3,100)	(10,399)
EBITDA	(758)	4,601	951	3,647
Net income	(7,237)	2,907	(5,727)	(12,790)
Basic EPS	($0.51)	$0.20	($0.43)	($1.01)
Diluted EPS	($0.51)	$0.19	($0.43)	($1.01)
Weighted average shares outstanding Basic (thousands)	14,260	14,232	13,417	12,626
Weighted average shares outstanding Diluted (thousands)	14,260	15,145	13,417	12,626
Average Swiss/Canadian exchange rate (1)	1.1911	1.1147	1.0476	1.0397
Average Euro/Canadian exchange rate (1)	1.3843	1.3937	1.3497	1.3760

	IFRS			Previous Canadian GAAP
(thousands of dollars, except per unit amounts, earnings per share ("EPS"), exchange rates and shares outstanding, unaudited)	Q3 2010	Q2 2010	Q1 2010	Q4 2009
Sales	86,972	60,544	50,304	51,049
Operating income	5,932	2,374	3,430	6,292
EBITDA	8,800	8,334	5,105	7,885
Net income	5,232	41,816	(397)	3,720
Basic EPS	$0.44	$4.08	($0.04)	$0.36
Diluted EPS	$0.39	$3.65	($0.04)	$0.35
Weighted average shares outstanding Basic (thousands)	12,003	10,237	10,234	10,234
Weighted average shares outstanding Diluted (thousands)	13,482	11,450	10,234	10,487
Average Swiss/Canadian exchange rate (1)	1.0085	0.9278	0.9832	1.0341
Average Euro/Canadian exchange rate (1)	1.3438	1.3057	1.4381	1.5600

(1) Source – Bank of Canada (average noon rate for the period)

FORTRESS PAPER LTD.
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(Canadian dollars, amounts in thousands, unaudited)

	September 30, 2011 $	December 31, 2010 $	January 1, 2010 $
ASSETS			
Current			
Cash and cash equivalents	14,570	42,559	33,205
Trade accounts receivable	16,778	10,616	18,034
Other accounts receivable *(note 7)*	42,288	20,615	2,614
Inventories	52,235	41,164	26,064
Prepaid expenses	3,291	1,755	873
	129,162	116,709	80,790
Restricted cash	2,562	1,362	45
Property, plant and equipment	292,878	186,774	66,861
Employee future benefits	–	1,768	809
Total assets	424,602	306,613	148,505
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current			
Accounts payable and accrued liabilities	62,231	38,878	22,447
Income taxes payable	2,008	3,503	4,446
Current portion of long-term debt *(note 8)*	8,572	8,977	5,378
	72,811	51,358	32,271
Long-term debt *(note 8)*	87,294	45,758	18,039
Deferred income taxes	16,521	18,526	3,227
Provisions	185	185	–
Employee future benefits	3,138	–	–
Total liabilities	179,949	115,827	53,537
Shareholders' equity			
Share capital *(note 9)*	175,154	111,148	59,083
Contributed surplus	9,946	10,536	3,198
Accumulated other comprehensive income	6,779	1,909	–
Retained earnings	52,774	67,193	32,687
Total shareholders' equity	244,653	190,786	94,968
Total liabilities and shareholders' equity	424,602	306,613	148,505

Commitments *(note 13)*

(See accompanying notes)

Approved by the Board of Directors:

"Chadwick Wasilenkoff" — Director

"Richard Whittall" — Director

FORTRESS PAPER LTD.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Canadian dollars, amounts in thousands, unaudited)

	Three Months Ended September 30, 2011 $	Three Months Ended September 30, 2010 $	Nine Months Ended September 30, 2011 $	Nine Months Ended September 30, 2010 $
Sales	83,995	86,972	259,389	197,820
Costs and expenses				
Cost of products sold	(75,490)	(69,923)	(226,827)	(158,755)
Amortization	(3,668)	(2,229)	(10,570)	(5,522)
Selling, general and administration	(9,263)	(8,249)	(27,771)	(20,199)
Stock-based compensation	(450)	(639)	(1,580)	(1,610)
Operating income (loss)	(4,876)	5,932	(7,359)	11,734
Other income (expense)				
Finance expense	(872)	(188)	(2,936)	(670)
Finance income	37	68	270	101
Fair value gain on acquisition *(note 5)*	–	–	–	41,804
Foreign exchange gain (loss)	525	1,483	4,293	(1,724)
Net income (loss) before income taxes	(5,186)	7,295	(5,732)	51,245
Income tax expense	(2,051)	(2,063)	(4,327)	(4,598)
Net income (loss) for the period	(7,237)	5,232	(10,059)	46,647
Earnings (loss) per share				
Basic	(0.51)	0.44	(0.72)	4.31
Diluted	(0.51)	0.39	(0.72)	3.92
Weighted average number of shares outstanding				
Basic	14,260,443	12,003,313	13,973,067	10,831,157
Diluted	14,260,443	13,482,157	13,973,067	11,913,576

(See accompanying notes)

FORTRESS PAPER LTD.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Canadian dollars, amounts in thousands, unaudited)

	Three Months Ended September 30, 2011 $	Three Months Ended September 30, 2010 $	Nine Months Ended September 30, 2011 $	Nine Months Ended September 30, 2010 $
Net income (loss) for the period	(7,237)	5,232	(10,059)	46,647
Other comprehensive income (loss)				
Cumulative translation adjustment	(235)	5,029	4,870	2,050
Actuarial (loss) recognized on employee future benefits (net of taxes of $869, $70, $879 and $672)	(4,317)	(352)	(4,365)	(3,338)
Asset limit on employee future benefits (net of taxes of $nil, $nil, ($1), and ($447))	–	–	5	2,224
Total other comprehensive income (loss) for the period	(4,552)	4,677	510	936
Total comprehensive income (loss) for the period	(11,789)	9,909	(9,549)	47,583

(See accompanying notes)

FORTRESS PAPER LTD.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(Canadian dollars, amounts in thousands, unaudited)

	Share capital $	Contributed surplus $	Accumulated other comprehensive income (loss) $	Retained earnings $	Total equity $
Balance – December 31, 2010	111,148	10,536	1,909	67,193	190,786
Net loss for the period	–	–	–	(10,059)	(10,059)
Other comprehensive income (net of tax)	–	–	510	–	510
Comprehensive income (loss) for the period	–	–	510	(10,059)	(9,549)
Employee future benefit adjustments moved to retained earnings	–	–	4,360	(4,360)	–
Employee share options *(note 10)*:					
Stock based compensation	–	1,580	–	–	1,580
Restricted share units vested	980	(980)	–	–	–
Options exercised	881	(242)	–	–	639
Redemption of convertible note *(note 8)*	7,363	(948)	–	–	6,415
Private placement *(note 9)*	54,782	–	–	–	54,782
Balance – September 30, 2011	175,154	9,946	6,779	52,774	244,653
Balance – January 1, 2010	59,083	3,198	–	32,687	94,968
Net income for the period	–	–	–	46,647	46,647
Other comprehensive loss (net of tax)	–	–	936	–	936
Comprehensive income (loss) for the period	–	–	936	46,647	47,583
Employee future benefit adjustments moved to retained earnings	–	–	1,114	(1,114)	–
Employee share options *(note 10)*:					
Stock based compensation	–	1,610	–	–	1,610
Deferred share units paid in cash	–	(93)	–	–	(93)
Deferred share units vested	–	(151)	–	–	(151)
Private placement *(note 9)*	42,347	–	–	–	42,347
Convertible note *(note 8)*	–	2,031	–	–	2,031
Balance – September 30, 2010	101,430	6,595	2,050	78,220	188,295

(See accompanying notes)

FORTRESS PAPER LTD.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the nine months ended
(Canadian dollars, amounts in thousands, unaudited)

	September 30, 2011 $	September 30, 2010 $
Cash flows (used by) from operating activities		
Net (loss) income	(10,059)	46,646
Items not affecting cash:		
Amortization	10,570	5,522
Deferred income taxes	(1,259)	172
Foreign exchange (gain) loss	(2,911)	2,995
Finance expense	2,216	675
Fair value gain on acquisition *(note 5)*	–	(41,804)
Stock based compensation	1,580	1,619
	137	15,825
Change in non-cash working capital items		
Accounts receivable	(7,190)	(5,076)
Inventories	(9,072)	(8,603)
Prepaid expenses	(1,536)	(944)
Accounts payable and accrued liabilities and other	7,624	2,612
	(10,037)	3,814
Cash flows from (used by) financing activities		
Options exercised	639	–
Repayment of long-term debt	(7,110)	(1,635)
Proceeds from long-term debt	35,145	30,053
Net proceeds from issuance of common shares	54,782	42,347
Payment on capital leases	(202)	(180)
Deferred Share Units vesting	–	(244)
Payment of long-term debt interest	(1,692)	(542)
	81,562	69,799
Cash flows (used by) investing activities		
Additions to property, plant and equipment	(99,227)	(35,949)
Restricted cash	(1,130)	(470)
Proceeds from Green Transformation Program *(note 12)*	2,000	–
Acquisition of Thurso pulp mill *(note 5)*	–	(3,000)
Acquisition of Fortress Optical Features (*note 6*)	(750)	–
	(99,107)	(39,419)
Increase (decrease) in cash position	(27,582)	34,194
Foreign exchange loss on cash and cash equivalents	(407)	(1,912)
Cash and cash equivalents, beginning of year	42,559	33,205
Cash and cash equivalents, end of period	14,570	65,487

Supplementary cash flow information *(note 15)*

(See accompanying notes)

1. NATURE OF OPERATIONS

Fortress Paper Ltd. (the "Company" or "Fortress") was incorporated on May 30, 2006 under the laws of the Province of British Columbia. The address of the Company's registered office is 157 Chadwick Court – 2nd floor, North Vancouver, British Columbia, Canada V7M 3K2. From the date of incorporation to July 31, 2006, the Company was inactive. The Company's fiscal year-end is December 31. Fortress owns and operates two paper mills, the Landqart mill located in Switzerland and the Dresden mill located in Germany, and a pulp mill in Canada. Fortress' security papers include banknote, passport and visa papers. The security papers produced at the Landqart mill incorporate internationally recognized overt and covert security features which are embedded into the paper and supplemented with customer-specific features. The Landqart mill has leveraged its extensive security papers competence to develop additional commercial applications using its in-house know-how and technology of security features to create innovative paper-based security products. Fortress' specialty papers business includes non-woven wallpaper base products, as well as graphic and technical papers. The Dresden mill produces coated and uncoated wallpaper base for wallpaper manufacturers. The pulp mill, Fortress Specialty Cellulose, produces northern bleached hardwood kraft and is in the process of being converted into a dissolving pulp mill.

2. BASIS OF PRESENTATION AND ADOPTION OF IFRS

The Company prepares its financial statements in accordance with Canadian generally accepted accounting principles as set out in the Handbook of the Canadian Institute of Chartered Accountants ("CICA Handbook"). In 2010, the CICA Handbook was revised to incorporate International Financial Reporting Standards ("IFRS"), and require publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, the Company has commenced reporting on this basis in these condensed interim consolidated financial statements. In these financial statements, the term "Canadian GAAP" refers to Canadian GAAP before the adoption of IFRS.

These condensed interim consolidated financial statements have been prepared in accordance with IFRS applicable to the preparation of interim financial statements, including IAS 34 and IFRS 1. Subject to certain transition elections disclosed in note 4, the Company has consistently applied the same accounting policies in its opening IFRS statement of financial position at January 1, 2010 and throughout all periods presented, as if these policies had always been in effect. Note 4 discloses the impact of the transition to IFRS on the Company's reported financial position, financial performance and cash flows, including the nature and effect of significant changes in accounting policies from those used in the Company's consolidated financial statements for the year ended December 31, 2010.

The policies applied in these condensed interim consolidated financial statements are based on IFRS issued and outstanding as of November 4, 2011, the date the Board of Directors approved the statements. Any subsequent changes to IFRS that are given effect in the Company's annual consolidated financial statements for the year ending December 31, 2011 could result in restatement of these interim consolidated financial statements, including the transition adjustments recognized on change-over to IFRS.

The condensed interim consolidated financial statements should be read in conjunction with the Company's Canadian GAAP annual financial statements for the year ended December 31, 2010 and the Company's first quarter 2011 condensed interim financial statements.

3. NEW ACCOUNTING PRONOUNCEMENTS

The following IFRS have been issued by the International Accounting Standards Board ("IASB"), and adopted for use in Canada by the Accounting Standards Board:

IFRS 9 - Financial Instruments

In November 2009, the IASB issued IFRS 9, Financial Instruments. This standard addresses classification and measurement of financial assets and replaces the multiple category and measurement models in IAS 39 for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit and loss. IFRS 9 also replaces the models for measuring equity instruments with recognition at fair value through profit or loss or at fair value through other comprehensive earnings.

IFRS 9 is effective for annual periods beginning on or after January 1, 2013. The Company is currently assessing the impact of this standard on the financial statements.

IFRS 10 - Consolidated Financial Statements

In May 2011, the IASB issued IFRS 10, Consolidated Financial Statements. IFRS 10 establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. This IFRS defines the principle of control and establishes control as the basis for determining which entities are consolidated in an entity's consolidated financial statements. IFRS 10 sets out three elements of control: a) power over the investee; b) exposure, or rights, to variable returns from involvement with the investee; and c) the ability to use power over the investee to affect the amount of the investors return. IFRS 10 sets out the requirements on how to apply the control principle. IFRS 10 and IFRS 12 supersede IAS 27, Consolidated and Separate Financial Statements and SIC-12, Consolidation – Special Purpose Entities.

This standard is effective for annual periods beginning on or after January 1, 2013, with earlier application permitted if adopted along with IFRS 11, IFRS 12, IAS 27 (revised) and IAS 28 (revised). The Company is currently assessing the impact of these standards on the financial statements.

IFRS 11 – Joint Arrangements

In May 2011, the IASB issued IFRS 11, Joint Arrangements, which provides guidance on accounting for joint arrangements. If an arrangement has joint control, IFRS 11 classifies joint arrangements as either joint operations or joint ventures, depending on the rights and obligations of the parties involved.

A joint operation is an arrangement where the jointly controlling parties have rights to the assets and obligations in respect of the liabilities relating to the arrangement. An entity accounts for a joint operation by recognizing its portion of the assets, liabilities, revenues and expenses. A joint venture is an arrangement where the jointly controlling parties have rights to the net assets of the arrangement. A joint venture is accounted for using the equity method. Proportionate consolidation is no longer permitted.

This standard is effective for annual periods beginning on or after January 1, 2013, with early adoption permitted. This standard is not expected to have a significant impact on the financial statements as Fortress currently has no joint arrangements.

IFRS 12 – Disclosure of Interests in Other Entities

In May 2011, the IASB issued IFRS 12, Disclosure of Interests in Other Entities. IFRS 12 outlines the disclosure requirements for interests in subsidiaries and other entities to enable users to evaluate the risks associated with interests in other entities and the effects of those interests on an entity's financial position, financial performance and cash flows. IFRS 10 and IFRS 12 supersede IAS 27, Consolidated and Separate Financial Statements and SIC-12, Consolidation – Special Purpose Entities.

This standard is effective for annual periods beginning on or after January 1, 2013, with early adoption permitted. The Company is currently assessing the impact of this standard on the financial statements.

IFRS 13 – Fair Value Measurement

In May 2011, the IASB issued IFRS 13, Fair Value Measurement ("IFRS 13"). This standard defines fair value, sets out a single IFRS framework for measuring fair value and outlines disclosure requirements about fair value measurements. IFRS 13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is a market-based measurement, not an entity-specific measurement so assumptions that market participants would use should be applied in measuring fair value.

This standard is effective for annual periods on or after January 1, 2013, with earlier application permitted. This IFRS is to be applied prospectively as of the beginning of the annual period in which it is initially applied and the disclosure requirements do not need to be applied in comparative periods before initial application. The Company is currently assessing the impact of this standard on the financial statements.

IAS 19 – Employee Future Benefits

In June 2011, the IASB issued an amended version of IAS 19, Employee Benefits. The amendments to IAS 19 are meant to improve the quality, transparency and comparability of information presented for post-employment benefits. For defined benefit plans, the amendments eliminate the option to defer actuarial gains and losses on the balance sheet through the "corridor method". The amendments also require any remeasurement gains or losses, including actuarial gains and losses, to be recognized immediately and presented in other comprehensive income, eliminating the option to recognize and present these through the income statement. Additional disclosures will also be required to present better information about the characteristics, amounts recognized, and risks related to defined benefit plans.

The amendments to IAS 19 are effective for financial years beginning on or after January 1, 2013 with earlier adoption permitted. The Company is currently assessing the impact of these amendments on the financial statements.

4. TRANSITION TO IFRS

The effect of the Company's transition to IFRS, as described in Note 2, is summarized in this note as follows:

(i) Transition elections

The Company has applied the following transition exemptions to full retrospective application of IFRS:

As described in

(Canadian dollars, amounts in thousands except share and per share data, unaudited)

	Note 4 (ii)
Deemed cost of property, plant and equipment	a
Employee benefits – treatment of actuarial gains and losses	b
Cumulative translation adjustment	c
Business combinations	d
Borrowing costs	e

(ii) Reconciliation of equity and comprehensive income as previously reported under Canadian GAAP to IFRS

	Ref	**December 31, 2010 $**	**September 30, 2010 $**	**January 1, 2010 $**
Equity				
Equity as reported under Canadian GAAP		180,266	177,806	86,584
IFRS adjustments increase (decrease):				
Foreign exchange on property, plant and equipment	a	3,321	3,841	2,176
Foreign exchange on inventory	a	(23)	1,094	(816)
Employee future benefits – actuarial gains and losses	b	(8,753)	(11,157)	(6,295)
Property, plant and equipment revaluation	f	16,833	16,833	16,833
Employee future benefits – asset limit	g	(43)	(38)	(2,784)
Deferred income tax	h	(1,572)	(890)	(1,199)
Deferred expenses	i	–	–	(476)
Long term debt revaluation	j	757	806	945
Equity as reported under IFRS		190,786	188,295	94,968

(Canadian dollars, amounts in thousands except share and per share data, unaudited)

	Ref	Year ended December 31, 2010 $	Nine months ended September 30, 2010 $
Comprehensive income			
As reported under Canadian GAAP		34,753	45,705
Increase (decrease) in net income for:			
Deferred income tax	h	(143)	175
Deferred expenses	i	476	476
Interest expense	j	(222)	(163)
Foreign exchange on translation of foreign operations	k	(613)	999
Depreciation and other	k	52	61
Stock based compensation	l	(227)	(227)
Redemption of convertible note	m	(246)	–
Employee future benefits	n	33	(379)
		33,863	46,647
Increase (decrease) in comprehensive income for:			
Cumulative translation adjustment	k	1,915	2,050
Employee future benefits – actuarial gains and losses	b	(1,582)	(3,338)
Employee future benefits – asset limit	g	2,224	2,224
		2,557	936
As reported under IFRS		36,420	47,583

(a) Under IFRS, non-monetary balance sheet items denominated in a foreign currency are translated into the presentation currency of the Company using the exchange rate in place at the balance sheet date for foreign subsidiaries being consolidated. Under Canadian GAAP non-monetary balance sheet items for integrated subsidiaries were translated using historical rates. Property, plant and equipment and inventory in Germany and Switzerland have been revalued for IFRS using the exchange rates in place as at the balance sheet date.

(b) Under IFRS, the Company recognizes actuarial gains and losses arising from the re-measurement of employee future benefit obligations in other comprehensive income as they arise. Under Canadian GAAP, the company applied the corridor method of accounting for such gains and losses. Under this method, gains and losses are recognized only if they exceed specified thresholds. The carrying value of the net asset for employee future benefits was reduced by $6,295 as at January 1, 2010 to recognize previously unamortized accumulated actuarial gains and losses. Actuarial losses of $4,009 previously unrecognized under Canadian GAAP were recognized for the nine months ended September 30, 2010 for IFRS. Actuarial losses of $1,900 previously unrecognized under Canadian GAAP were recognized for the year ended December 2010 for IFRS.

(c) In accordance with IFRS transitional provisions, the Company has elected to reset the cumulative translation adjustment account, which includes gains and losses arising from the translation of foreign operations, to zero at the date of transition to IFRS. Under Canadian GAAP the cumulative translation adjustment was also zero based on foreign subsidiaries being treated as integrated operations. As such, no adjustment is necessary to retroactively restate the cumulative translation adjustment account as at the date of transition to IFRS.

(d) In accordance with IFRS transitional provisions, the Company elected to apply IFRS relating to business combinations prospectively from January 1, 2010. As such, Canadian GAAP balances relating to business combinations entered into before that date have been carried forward without adjustment.

(Canadian dollars, amounts in thousands except share and per share data, unaudited)

(e) In accordance with IFRS transitional provisions, the Company has elected to apply IFRS relating to borrowing costs prospectively from January 1, 2010. As such, Canadian GAAP balances relating to long term debt arrangements entered into for the construction of property, plant and equipment before that date have been carried forward without adjustment.

(f) In accordance with IFRS transitional provisions, the Company elected to revalue land in Germany and Switzerland by $16,833 to its fair value as at January 1, 2010. There has been no corresponding change to income or accumulated amortization.

(g) Under IFRS, IFRIC 14 provides specific guidance on the calculation of the amount of an employee future benefit asset a company can recognize. Based on this guidance the employee future benefit recognized on the balance sheet of the Company will be $0.8 million as at January 1, 2010, $nil as at September 30, 2010 and $1.8 million as at December 31, 2010.

(h) Deferred income tax liabilities have been adjusted to give effect to adjustments as follows:

	Ref	December 31, 2010 $	September 30, 2010 $	January 1, 2010 $
Property, plant and equipment revaluation	a	3,273	2,851	2,932
Employee future benefits – actuarial gains and losses	b	(1,588)	(1,856)	(1,201)
Employee future benefits – asset limit	g	(113)	(105)	(532)
		1,572	890	1,199

Under IFRS, deferred income tax amounts related to actuarial gains and losses on employee future benefits and the limit on the asset for employee future benefits are recognized by the Company in other comprehensive income. Under Canadian GAAP, deferred income tax amounts related to employee future benefits were recorded in net income.

(i) Under IFRS, all acquisition related costs of the acquirer in a business combination must be accounted for as expenses in the period in which they were incurred. Under Canadian GAAP incremental costs that were directly attributable to the purchase were included in the purchase price. As a result of this change the Company has charged $476 in deferred expenses previously recognized as an asset under Canadian GAAP directly to equity as at January 1, 2010. Net income was also increased by $476 for the nine months ended September 30, 2010 and increased by $476 for the year ended December 31, 2010 as a result of this change.

(j) Upon conversion to IFRS a non-interest bearing loan with a principal amount of $5,366 was valued at amortized cost of $4,440 using an imputed interest rate of 5%. This resulted in a decrease in long term debt and an increase in retained earnings of $945 as at January 1, 2010. The imputed interest expense was $162 for the nine months ended September 30, 2010 and $222 for the year ended December 31, 2010.

(k) Under IFRS, The financial statements of entities that have a functional currency other than Canadian ("foreign operations") are translated into Canadian dollars as follows: assets and liabilities – at the closing rate at the date of the statement of financial position, and income and expenses – using actual rates in place at the time or an average rate if it is considered a reasonable approximation. All resulting changes are recognized in other comprehensive income as cumulative translation adjustments.

Under Canadian GAAP, monetary assets and liabilities are translated at the closing rate at the date of the statement of financial position with translation adjustments being recognized in income. Non-monetary assets and liabilities are translated using historical foreign exchange rates. Depreciation related to property, plant and equipment was translated at historical foreign exchange rates. All other income and expense items were translated using average exchange rates for the period.

As such, depreciation expense and property, plant and equipment were decreased by $61 for the nine months ended September 30, 2010 and decreased by $52 for the year ended December 31, 2010.

Other comprehensive income was increased by $2,050 for the nine months ended September 30, 2010 and increased by $1,915 for the year ended December 31, 2010 to record a cumulative translation adjustment.

(l) Under IFRS, when share based payment awards vest in installments over the vesting period (graded vesting), each installment is accounted for as a separate arrangement. This treatment is allowed under Canadian GAAP but was not used by the Company. The Company's former policy under Canadian GAAP was to recognize stock based compensation straight line over the vesting period. This change in treatment has resulted in an increase to contributed surplus and a decrease in retained earnings of $110 for share-based awards that were issued to officers of the Company but had not fully vested as at January 1, 2010. For the nine months ended September 30, 2010 the Company recorded an increase in contributed surplus and an increase in stock-based compensation of $227. For the year ended December 31, 2010, the Company recorded an increase in contributed surplus and an increase in stock based compensation of $227.

(m) Under IFRS, the conversion of the convertible note is treated as an increase in share capital with no gain or loss recorded. Under Canadian GAAP, the liability and equity components were re-valued at the time of conversion with a gain or loss recognized in income and an adjustment made to retained earnings. As such, during the year ended December 31, 2010 retained earnings was increased by $166 and income was decreased by $246 as a result of the partial conversion of a convertible note on October 1, 2010. Share capital was increased by $80 for the year ended December 31, 2010.

(n) Under IFRS, the Company has chosen an accounting policy for employee future benefits that recognizes all actuarial gains and losses in other comprehensive income in the period in which they occur. Under Canadian GAAP, the Company amortized these gains and losses to income using the corridor method.

(iii) Adjustments to the statements of cashflows

The transition from Canadian GAAP to IFRS had no significant impact on cashflows generated by the Company. The IFRS transition adjustments did not have an impact on cash and cash equivalents.

5. ACQUISITION OF THURSO PULP MILL

On April 30, 2010, the Company completed the purchase of a northern bleached hardwood kraft pulp mill located in Thurso, Quebec from Fraser Papers Inc. through a wholly-owned subsidiary, Fortress Specialty Cellulose Inc. ("Fortress Specialty Cellulose" or "FSC"), for $3 million. The Company is in the process of converting the Thurso operations into a dissolving pulp mill.

The recognition of assets acquired and liabilities assumed is based upon estimated fair values at the date of acquisition. Fair values are estimated using market information where applicable; however, directly comparable information is not always readily available so significant estimates and judgment are used. The Company believes it has made reasonable assumptions with respect to determining the fair values recognized.

(Canadian dollars, amounts in thousands except share and per share data, unaudited)

A gain of $41,804 has been recognized as the estimated fair values of the net assets acquired exceed consideration paid. The gain has been included as other income in the statement of operations.

The acquisition has been accounted for as follows:

Assets acquired at fair values:	
Inventory	$ 6,019
Property, plant and equipment	58,915
	64,934
Liabilities assumed at fair values:	
Accounts payable	$ 3,652
Asset retirement obligations	562
Future income tax liabilities	15,916
	20,130
Net assets acquired at fair values	44,804
Consideration paid	3,000
Fair value gain on acquisition	$ 41,804

6. ACQUISITION OF FORTRESS OPTICAL FEATURES

In January of 2011 the Company completed the purchase of optical security assets which produces security material for the security threads used in banknotes. The assets were purchased through a wholly-owned subsidiary, Fortress Optical Features Ltd. (“Fortress Optical Features” or “FOF”) for $750. The assets will be relocated to a high security production and research facility that the Company will be building adjacent to its FSC mill in Quebec.

The recognition of assets acquired and liabilities assumed is based upon estimated fair values at the date of acquisition. Fair values are estimated using market information where applicable; however, directly comparable information is not always readily available so significant estimates and judgment are used. The Company believes it has made reasonable assumptions with respect to determining the fair values recognized.

The acquisition has been accounted for as follows:

Assets acquired at fair values:	
Inventory	$ 126
Property, plant and equipment	624
	750
Liabilities assumed at fair values	$ --
Net assets acquired at fair values	750
Consideration paid	$ 750

(Canadian dollars, amounts in thousands except share and per share data, unaudited)

7. OTHER ACCOUNTS RECEIVABLE

	September 30, 2011 $	December 31, 2010 $	January 1, 2010 $
Receivable from lender *(note 8)*	20,111	4,516	–
Government grant *(note 12)*	3,155	–	–
Value added tax	9,735	7,250	1,179
Holdbacks receivable	5,937	6,593	–
Other	3,350	2,256	1,435
	42,288	20,615	2,614

8. LONG-TERM DEBT

	September 30, 2011 $	December 31, 2010 $	January 1, 2010 $
Credit agreement with bank maturing 2013; interest at 2.65% secured by current assets (EUR 385; Dec 2010 : EUR 2,431; Jan 2010 : EUR 3,223)	538	3,238	4,835
Credit agreement with lender maturing 2018; interest at 6.2% and 7.1% secured by fixed assets (EUR 20,297; Dec 2010 : EUR 15,377; Jan 2010 : EUR 0) (a)	28,357	20,481	–
Credit agreement with bank maturing 2012; interest at 4.8% unsecured (CHF 2,355; Dec 2010 : CHF 3,140; Jan 2010 : CHF 4,710)	2,703	3,344	4,760
Credit agreement with bank maturing 2011, 2013 and 2018; interest up to 3.1% and 4.9% secured by fixed assets (CHF 6,480; Dec 2010 : CHF 7,560; Jan 2010 : CHF 8,820)	7,439	8,048	8,914
Credit agreement with lender maturing 2016; unsecured (CHF 4,708; Dec 2010: CHF 4,598; Jan 2010: CHF 4,375) (b)	5,405	4,895	4,422
Capital leases; interest at 4.0% (EUR 0; Dec 2010 : EUR 147; Jan 2010 : EUR 324)	–	196	486
Credit agreement with lender maturing 2015; interest at 7% unsecured (c)	–	6,248	–
Credit agreement with lender maturing 2020; interest up to 5.5% secured by assets (d)	51,424	8,285	–
	95,866	54,735	23,417
Less: Current portion	(8,572)	(8,977)	(5,378)
	87,294	45,758	18,039

Borrowings under the above agreements require maintenance of certain financial and non-financial covenants. The Company has been in compliance with all covenants for the three months ended September 30, 2011.

(a) The credit agreement is a facility for up to EUR 22.2 million, of which EUR 22.2 million has been drawn as at September 30, 2011. The facility bears interest at a rate of 6.2% up until March 2011. Beginning in March 2011, the loan is repayable in equal installments over 7 years and bears interest at a rate of 7.1%.

Interest has been calculated at 7.6% using the effective interest rate method.

(b) The credit agreement is a facility for CHF 5.3 million that bears no interest and is repayable based on the timing of production for the lender. Interest has been imputed at 5%.

(c) The convertible debt ("Convertible Note") is an unsecured convertible note of the Company in the principal amount of $15,000 that matures in April 2015. The Convertible Note bears interest at an annual rate equal to 7%, calculated semi-annually with the first installment due on October 31, 2010.

Commencing April 30, 2010, the holder of the Convertible Note (the "Holder") may, at its option, convert the Convertible Note into common shares at any time until the close of business on the last business day prior to maturity. The conversion price shall be equal to $20.00 per share.

The Company may redeem the Convertible Note on or after April 30, 2012, at its option and repay in advance this option in whole or in part at par plus accrued and unpaid interest if the volume weighted average trading price of common shares on the TSX during 20 consecutive trading days, is not less than $25.00 per share.

The Company has initially recorded a liability portion of $12,969 and an equity portion of $2,031 in contributed surplus. The liability portion was valued using a 10.8% initial interest rate.

In October 2010, the Holder elected to convert $8,000 of the Convertible Note into 400,000 common shares. As a result, contributed surplus was decreased by $1,083, long-term debt was decreased by $6,996 and share capital was increased by $8,079 for the year ended December 31, 2010.

In February 2011, the Holder elected to convert the remaining $7,000 of the Convertible Note into 350,000 common shares. As a result, contributed surplus was decreased by $948, long-term debt was decreased by $6,415, and share capital was increased by $7,363.

(d) The credit agreement is a facility for up to $102.4 million, granted to Fortress Specialty Cellulose to support the conversion to dissolving pulp and co-generation capital expenditure programs. At December 31, 2010, $9.2 million has been drawn on this facility. Of this amount $4.5 million has been included in other accounts receivable. At September 30, 2011, $51.8 million has been drawn on this facility. Of this amount $20.1 million has been included in other accounts receivable. The facility bears interest at a rate of 5% for the first five years of the loan and at a rate of up to 5.5% for the second five years of the loan. Commencing after two years, the facility is repayable in equal quarterly installments up to June 30, 2020. Interest for the first two years of the credit agreement is added to the principal of the loan.

Interest has been calculated at 5.6% using the effective interest rate method.

(Canadian dollars, amounts in thousands except share and per share data, unaudited)

9. SHARE CAPITAL

(a) **Authorized:**

Unlimited number of common shares without par value
Unlimited number of preferred shares with par value $1,000

(b) **Issued and fully paid — common shares**:

	Number of Shares	**Share Capital $**
Balance, December 31, 2009	10,233,500	59,083
Private placement	1,900,050	42,344
Restricted share units vested (*note 10*)	65,038	684
Options exercised (*note 10*)	85,000	958
Shares issued on redemption of Convertible Note (*note 8*)	400,000	8,079
Balance, December 31, 2010	12,683,588	111,148
Private placement	1,112,050	54,782
Restricted share units vested *(note 10)*	65,998	980
Options exercised *(note 10)*	80,250	881
Shares issued on redemption of Convertible Note *(note 8)*	350,000	7,363
Balance, September 30, 2011	14,291,886	175,154

In February 2011, the Company completed a private placement of 1,112,050 shares for total net proceeds of $54,782 after transaction costs of $2,765.

During the year ended December 31, 2010, the Company completed a private placement of 1,900,050 shares for total net proceeds of $42,344 after transaction costs of $2,308.

10. STOCK-BASED COMPENSATION

During 2006, the Company adopted a stock incentive plan. The exercise price of options granted under the stock option plan shall be as determined by the Board of Directors when such options are granted, subject to any limitations imposed by any relevant stock exchange or regulatory authority.

At the Company’s annual general meeting held April 30, 2009, shareholders approved a long-term incentive plan which provides for the grant of restricted share units, performance share units and deferred share units to key employees and directors of the Company. The aggregate number of shares issuable under the long-term incentive plan in respect of awards, together with shares reserved for issuance under all of the Company's other security-based compensation arrangements, shall not exceed ten percent of the Company's issued and outstanding shares.

Stock Options

The weighted average fair value of the options granted in 2009 was $2.98 an option at the grant date using the Black Scholes option pricing model. No options were granted in 2010 or during the nine months ended September 30, 2011. Option pricing models require the input of highly subjective assumptions including the expected volatility. Changes in the assumptions can materially affect the fair value estimate, and, therefore, the existing models do not necessarily provide a reliable measure of the fair value of the Company's stock options. Assumptions used in the pricing model are as follows:

(Canadian dollars, amounts in thousands except share and per share data, unaudited)

	2009
Risk-free interest rate	1.78%
Expected life of options	5 years
Annualized volatility	53%
Dividend rate	Nil

Stock option transactions and the number of stock options outstanding are summarized as follows:

	Number of options	**Exercise Price**
Balance, December 31, 2009	740,175	$ 8.00
Exercised	(85,000)	8.00
Balance, December 31, 2010	655,175	$ 8.00
Exercised	(80,250)	8.00
Balance, September 30, 2011	574,925	$ 8.00

As at September 30, 2011, 574,925 stock options were exercisable (December 31, 2010: 643,508). The stock options issued have various vesting dates that range from one to three years from the IPO or grant dates.

Deferred Share Unit Awards

A Deferred Share Unit ("DSU") is a right granted to a non-employee director to receive one common share of the Company, from treasury, on a deferred basis. The value of the DSUs, when redeemed, is equal to the market value of the shares on the redemption date, including the value of dividends paid on the Company's common shares, if any, as if they had been reinvested in additional DSUs on each payment date. The DSUs may only be redeemed upon a director's retirement from the Company. The Company recognizes the expense at the time of grant.

DSU transactions and the number of DSUs outstanding are summarized as follows:

	Number of DSUs	**Expense recognized $**
Balance, December 31, 2009	26,000	185
Granted	121,481	5,134
Redeemed	(8,458)	151
Balance, December 31, 2010	139,023	5,470
Granted	3,241	148
Balance, September 30, 2011	142,264	5,618

(Canadian dollars, amounts in thousands except share and per share data, unaudited)

Restricted Share Unit Awards

A Restricted Share Unit ("RSU") is a right granted to a key employee to receive one common share of the Company, from treasury, on a time vested basis. The fair value of restricted share awards is determined based upon the number of shares granted and the quoted price of the Company's stock on the date of grant. Restricted shares generally vest over three to five years.

RSU transactions and the number of RSUs outstanding are summarized as follows:

	Number of RSUs
Balance, December 31, 2009	157,626
Granted	222,454
Vested	(65,038)
Balance, December 31, 2010	315,042
Granted	17,128
Vested	(65,998)
Balance, September 30, 2011	266,172

11. ACCUMULATED OTHER COMPREHENSIVE INCOME

Accumulated other comprehensive income is comprised of cumulative translation adjustments for all periods presented.

12. PULP AND PAPER GREEN TRANSFORMATION FUND

On June 17, 2009 the Canadian Federal Government announced the Pulp and Paper Green Transformation Program (the Program). The Program is designed as a reimbursement of funds to be spent on qualifying energy and environmental capital projects. Credits may be used until the program end date of March 31, 2012. The Company has been allocated $9.9 million from the Program announced by the Canadian government on June 28, 2011. The Company has received Program approval to apply the funding to the installation of lime kiln and recovery boiler upgrades at the Fortress Specialty Cellulose mill. These projects are expected to provide economic and environmental benefits to the Company's operations. As at September 30, 2011 the Company had received $2.0 million under the program and recorded $3.1 million as other receivables. The remaining $4.8 million is expected to be received before year end.

13. COMMITMENTS

As at September 30, 2011 the Company has committed to purchase $63.3 million in property, plant, and equipment.

As at September 30, 2011 the Company has performance bonds in the amount of EUR 1.0 million.

(Canadian dollars, amounts in thousands except share and per share data, unaudited)

14. SEGMENTED INFORMATION

The segmentation of the Company's manufacturing operations is based on a number of factors, including production, production processes, and economic characteristics. The Landqart mill and Fortress Optical Features produce security papers and products. The Dresden mill produces non-woven wallpaper base products. Fortress Specialty Cellulose produces pulp products.

	Three months ended September 30, 2011				
	Wallpaper	**Security**	**Pulp**	**Corporate**	**Fortress Paper Consolidated**
	$	$	$	$	$
Sales	35,778	11,330	36,887	–	83,995
Operating income (loss)	6,371	(8,258)	(859)	(2,130)	(4,876)
Amortization[1]	(799)	(1,995)	(874)	–	(3,668)
Stock-based compensation[1]	-	-	-	(450)	(450)
Capital expenditures	4,293	1,874	32,840	–	39,007
Total assets	63,547	148,011	208,952	4,092	424,602

Sales by geographic area	%
Europe	52.9
Asia	43.9
Other	3.2
Total	100.0

[1]Stock-based compensation and amortization are included in operating earnings (loss).

	Three months ended September 30, 2010				
	Wallpaper	**Security**	**Pulp**	**Corporate**	**Fortress Paper Consolidated**
	$	$	$	$	$
Sales	30,221	19,532	37,219	–	86,972
Operating income (loss)	4,470	(472)	4,442	(2,508)	5,932
Amortization[1]	(403)	(911)	(915)	–	(2,229)
Stock-based compensation[1]	–	–	–	(639)	(639)
Capital expenditures	353	9,640	4,445	–	14,438
Total assets	53,592	104,362	88,978	45,526	292,458

Sales by geographic area	%
Europe	75.8
Asia	14.2
North America	7.9
Other	2.1
Total	100.0

[1]Stock-based compensation and amortization are included in operating earnings (loss).

(Canadian dollars, amounts in thousands except share and per share data, unaudited)

	Nine months ended September 30, 2011				
	Wallpaper	Security	Pulp	Corporate	Fortress Paper Consolidated
	$	$	$	$	$
Sales	109,345	37,610	112,434	-	259,389
Operating income (loss)	20,181	(21,680)	1,515	(7,375)	(7,359)
Amortization[1]	(2,150)	(5,796)	(2,624)	-	(10,570)
Stock-based compensation[1]	-	-	-	(1,580)	(1,580)
Capital expenditures	9,427	18,786	70,916	-	105,130
Total assets	63,547	148,011	208,952	4,092	424,602

Sales by geographic area	%
Europe	53.4
Asia	37.5
North America	1.4
Other	7.7
Total	100.0

[1]Stock-based compensation and amortization are included in operating earnings (loss).

	Nine months ended September 30, 2010				
	Wallpaper	Security	Pulp	Corporate	Fortress Paper Consolidated
	$	$	$	$	$
Sales	90,345	56,713	50,762	-	197,820
Operating income (loss)	14,049	(226)	3,318	(5,407)	11,734
Amortization[1]	(1,475)	(2,523)	(1,524)	-	(5,522)
Stock-based compensation[1]	-	-	-	(1,610)	(1,610)
Capital expenditures	3,993	28,030	5,768	-	37,791
Total assets	53,592	104,362	88,978	45,526	292,458

Sales by geographic area	%
Europe	81.8
Asia	8.1
North America	6.8
Other	3.3
Total	100.0

[1]Stock-based compensation and amortization are included in operating earnings (loss).

15. SUPPLEMENTARY CASH FLOW INFORMATION

Non cash item

During the nine months ended September 30, 2011, 350,000 common shares of the Company were issued for the redemption of the Convertible Note *(note 8)*.